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COMMISSIONER

The Commonwealth of Massachusetts

Department of Revenue

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January 31, 1985

You inquire as to the Massachusetts income tax consequences of the creation of certain escrow accounts established for the purpose of effecting distributions under the plan of reorganization of the

("Corporation"). You inquire whether the Trustee in bankruptcy is subject to Massachusetts income taxation and whether Massachusetts income tax returns are required to be filed by the Trustee with respect to the escrow accounts.

The Corporation was incorporated in Massachusetts in 1968, and operated, through subsidiaries, as a diversified financial services company in the fields of life insurance, investment management, and oil and gas exploration and production. Shares of the Corporation's stock were traded over-the-counter.

In April, 1976, the Corporation filed a petition for relief under Chapter XI of the Federal Bankruptcy Act ("Act") in the United States District Court. On June 9, 1978, the case was ordered transferred to reorganization proceedings under Chapter X of the Act. On August 14, 1978, a Trustee was appointed by the Court to conduct the Corporation's business and to manage its property.

During the proceedings, the Court considered a number of plans of reorganization proposed by the Trustee and other interested parties. By an order dated September 16, 1981, the Court confirmed Trustee's Third Modified Plan of Reorganization of Corporation ("Plan").

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The Plan provided for the purchase of all of the outstanding stock of the Corporation by ("Purchasing Company"), or an affiliate, and for the distribution of the cash and of the common stock of the Corporation's subsidiary to the original stockholders following the payment of the allowed claims of the creditors and the payment of the price to repurchase the subsidiary. Under the Plan, a stockholder could elect, in lieu of cash, to receive his share in an interest-bearing promissory note from the Purchasing Company to the Corporation. The Trustee was to distribute the proceeds upon the maturity of the note. All rights to collect cash or common stock pursuant to the Plan would terminate five years after the final decree.

Under the Plan, title to 100 percent of the Corporation's common stock would pass to the Purchasing Company free and clear of all claims and interests.

The Plan provided that, until his discharge by the Bankruptcy Court, the Trustee would have all the powers conferred upon him by the Bankruptcy Act, the Court and other applicable law, and would be authorized to make decisions he deemed advisable to effect execution of the Plan.

Pursuant to agreements entered into prior to the sale of the Corporation's stock, the Trustee engaged

("Bank A") and

("Bank B") to hold proceeds from the sale of the Corporation's stock in certain escrow accounts and to invest, hold, and distribute money and securities from the sale as required by the Plan.

Each agreement could be terminated by the mutual consent of the Trustee and the Bank, or by Court order. Each agreement provided that the Trustee could transfer his rights and obligations under such agreement to the respective Bank, and provided that the Banks would use their best efforts to invest the funds in United States government obligations, obligations guaranteed by the United States government, repurchase agreements of qualified banks secured by such obligations, or certificates of deposit.

A debentureholders's account was established with Bank A, and a stockholder's account, a reserve account, and a debentureholder's account were established with Bank B. The reserve account was established in order to satisfy administrative expenses, post-closing expenses, and contested claims if resolved unfavorably to the Corporation.

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By letter dated December 21, 1982, the Internal Revenue Service held that the portion of the proceeds from the sale of the Corporation which was deposited with Banks A and B in various escrow accounts did not constitute a trust within the meaning of U.S. Treas. Reg. § 301.7701-4(a). U.S. Treas. Reg. § 301.7701-4(a) provides that, "generally speaking, an arrangement will be treated as a trust under the Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit."

Further, the Internal Revenue Service held that because the escrow accounts were not trusts, the accounts did not come within the scope of Code Section 6012 and no federal income tax returns needed to be filed on behalf of them. The Service cited Section 6012(a)(4) of the Code which provides that returns of income taxes shall be made by "every trust having for the taxable year any taxable income, or having gross income of \$600 or over, regardless of the amount of taxable income."

Taxable income under Chapter 62 of the Massachusetts General Laws is based upon federal gross income with certain adjustments. One of the items to be added to federal gross income in the determination of Massachusetts taxable income is any amount "included in or considered to be Massachusetts gross income under any other provision of this chapter." (G.L. c. 62, § 2(a)(F)).

Therefore, the fact that the Internal Revenue Service found that the escrow accounts were not trusts and had neither taxable income nor gross income of \$600 or more and that federal income tax returns did not need to be filed on behalf of the accounts is not determinative of whether the accounts have any Massachusetts taxable income.

Every executor, administrator, trustee, guardian, conservator, trustee in bankruptcy, and every fiduciary referred to in Section 25 of Chapter 62 shall make an annual return of his taxable income. (G.L. c. 62C, § 6(b)). Section 25 of Chapter 62 states that "[e]very individual who while an inhabitant of the commonwealth, and every executor, administrator, trustee or other fiduciary who while such an inhabitant or while acting under an appointment derived from a court of the commonwealth, has received any income taxable under this chapter...shall be subject to the taxes imposed by this chapter."

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The income received by trustees, executors, administrators, conservators, and trustees in bankruptcy is subject to the taxes imposed by Chapter 62 to the extent that the persons for whose benefit it is accumulated are inhabitants of Massachusetts. If the beneficiaries of such income are nonresidents of Massachusetts, the income will be taxable if the income would be subject to taxation under Section 5A of Chapter 62 if received by a nonresident. (G.L. c. 62, §§ 10(a), 13).

The income received by the Trustee from the escrow accounts in Banks A and B is considered Massachusetts gross income to the extent that the persons for whose benefit it is accumulated would be subject to taxation if they received such income.

Pursuant to Section 6(b) of Chapter 62C, the Trustee in bankruptcy must make an annual return of his taxable income. The Trustee must include in his Massachusetts return only that income which would be subject to Massachusetts taxation if it were received directly by the persons for whose benefit it is accumulated.

Very truly yours,



Commissioner of Revenue

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